What Trump's tax reform could mean for affordable housing

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November 2, 2017

The affordable housing shortage in the United States was put in stark terms in October when Freddie Mac reported that homes available to very low-income Americans dropped by more than 60 percent in just six years between 2010 to 2016.

The units, developed for people who make less than 50 percent of the area median income, have began to run short because of rising rents, stagnant wages, and fluctuations in federal programs that subsidize housing.

To affordable housing advocates, it's a clear signal that the country can hardly sustain a disruption to the construction of new affordable housing. Yet that's what the Trump administration's tax reform proposal— highlighted by a corporate income tax cut from 35 to 20 percent — risks doing if the tax incentives big banks receive to invest in affordable housing projects are weakened.

The proposal — released on Thursday — doesn't include a direct assault on the tax credit responsible for the vast majority of new affordable housing starts, known as the Low-Income Housing Tax Credit (LIHTC), but Trump's corporate tax cut proposal could have unintended and potentially dire consequences for a nation that's already spending more and more just to make rent.

A repeal of LIHTC, which appears to be averted for now, "would see protection and preservation of affordable housing grind to a near halt," said Andrea Ponsor, Executive Vice President for Policy at Stewards of Affordable Housing for the Future. "But I think folks are cautiously optimistic. I think there's a broad recognition on all sides of the aisle and all over the country that we need to invest in housing for people at all income levels."

LIHTC, created as part of the Tax Reform Act of 1986, plays a role in financing practically all new affordable housing construction in America. According to data provided by the U.S. Department of Housing and Urban Development (HUD), the program produced 2,402,484 low-income housing units between 1986 and 2016.

Every year, the IRS divvies LIHTCs to the states on a per capita basis. Each state's housing finance agency then fields housing project applications for the LIHTCs from developers who are willing to include affordable units in their buildings in exchange for the tax credits. Developers whose applications are approved then flip the LIHTCs to investors, mostly banks, to raise equity for their projects.

The program is referred to by advocates as "win-win" because developers get to finance their projects without a high debt burden, low-income residents get an affordable housing option, and banks get a real estate investment with an acceptable yield that satisfies their obligation to invest in the communities where they issue deposits, as required by the Community Reinvestment Act (CRA) of 1977.

As a safeguard to ensure developers and banks don't renege on terms of the deal, banks aren't allowed to realize the tax credits until the affordable housing units are occupied, and the credits have to be claimed over a 10-year period. The project must also remain affordable for 30 years or the investor, again likely a bank, risks recapture of its tax credits by the federal government. "Banks have to reinvest a certain percent in their neighborhoods and this is one way they get credit for that," said Michael Hollar, an economist with HUD. "I think that's why it gets such bipartisan support. It's a tax credit that Republicans generally like because it's lowering the tax burden, and it's really the only way to produce subsidized housing [construction] right now through the federal government."

With much of the private market focused on catering to high-end renters since the housing collapse 10 years ago, the LIHTC program doesn't just account for the majority of new affordable housing options for low-income Americans, it accounts for practically *all* of the new affordable housing options for low-income Americans, according to advocates who were asked to ballpark the number.

The program's safeguards are what ensure that existing affordable options stay that way. If you're a low-income American living in a rent-controlled affordable unit, chances are it was built with and is maintained by the LIHTC program. Advocates are reluctant to entertain eliminating the program or making substantial changes to it because it's really the only program producing affordable housing units. If you eliminate it, what are you going to replace it with? But the program certainly has its critics. Many argue that it's some combination of inefficient, insufficient, or too indirect a subsidy to low-income tenants. Vanessa Brown Calder, a policy analyst with the Libertarian think-tank Cato Institute, believes developers, banks, and intermediaries reap most of the benefit from LIHTCs. Citing a 2010 study from the University of Oklahoma, Calder believes tenant savings in rent account for only 35 percent of the value of the credits.

“Because it has such a complex allocation process, which is one of the problems with LIHTC, lots of bits of it are lost along the way before it ever ends up making its way to the tenant,” Calder said. “ Much of the LIHTC stock that’s produced ends up being market rate housing anyway. It’s not even particularly affordable.”

An NPR and Frontline investigation in May added fuel to critics’ fire that showed LIHTCs are producing fewer low-income housing units even as their cost to taxpayers is rising, something loosely attributed to the rising cost of construction material and a shortage in construction labor. Advocates for the program and affordable housing in general breathed a collective sigh of relief when the Trump administration’s tax reform framework, released last week, explicitly retained LIHTC, something not afforded to some of the other community investment tax credits. But that doesn’t mean other changes to the tax code won’t negatively impact LIHTCs and thus affordable housing construction.

Michael Novogradac of Novogradac & Company, an accounting firm that specializes in the real estate sector, said any percentage drop in the corporate tax rate would result in an equal percentage drop in the amount of equity developers would be able to raise with LIHTCs, and thus an equal percentage drop in the number of affordable housing units that would be built in the future.

Novogradac’s firm conducted an analysis that concluded that a corporate tax rate cut could result in as much as $2.2 billion less in available annual LIHTCs, and as many as 16,000 fewer new or preserved low-income housing units each year. In every scenario the analysis tested, a drop in the corporate tax rate resulted in fewer low-income housing units.

And in fact, this price decrease is already happening, even without tax reform having passed yet. Since Trump’s election in 2016, the market for LIHTCs have been pricing in the expectation of a 25 percent corporate tax rate, according to Novogradac. Just the mere specter of a corporate income tax cut has caused a drop in the amount of equity available for low-income housing.
The good news for LIHTC advocates is that two bills in Congress suggest that both the House and the Senate want to prevent further erosion of the program. The House bill makes various adjustments intended to streamline the financing process and preserve existing affordable housing. The companion bill in the Senate goes even further, proposing a 50 percent increase in credits allocated to the program.

But with uncertainty and confusion reigning in American politics today, it remains to be seen how these bills will factor into the tax reform effort, if they do at all.

“I never want to try and predict what Congress would do, but I have seen a lot of support for the program,” Hollar said. “The industry does a pretty good job of informing the Congress of the benefits of it, so I think I’d be a bit surprised if they did get rid of it completely.”